



# The Federal Report

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

## The Month in Washington: May 2006

### President Reclaims Stride, Congressional GOP Fractures

President Bush saw one of his promises through as Congress passed the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA). The legislation extends favorable tax treatment to capital gains and dividends until 2010, stabilizing the environment for investment and savings, according to the legislation's boosters. Popular public pension changes passed by the House were not included in that measure, and political pressure arising from their cost may also keep these benefit changes out of the second "trailer" tax bill percolating on the legislative agenda.

The White House also gets most of the credit for entering the contentious immigration debate to jump-start stalled Senate proceedings on the issue, rallying a coalition of 23 Republicans, 38 Democrats, and 1 Independent against 32 Republicans and 4 Democrats to gain approval of the measure. Now those favoring the Senate bill, which looks more like what the President had requested than the House legislation, have urged the President to take a more active roll to see the immigration bill through a conference expected to be somewhere between problematic and impossible, depending on whom one asks.

The Administration appeared re-energized by the addition of new personnel. Often cryptic Scott McClellan left as White House spokesman for the affable Fox Network anchor Tony Snow and Josh Bolten took over Chief of Staff duties from Andy Card, who had stayed in a notoriously wearing position for a nearly record-setting length of time. The Senate also confirmed former Ohio Congressman and public pension friend Rob Portman to his new position as Director of the Office of Management and Budget; he had previously served as United States Trade Representative.

The political see-saw has both an up and a down, of course, and it was Congress' turn to see its fortunes drop. Even as the President gets credit for fixing the immigration impasse, the Senate gets blame for creating it in the first place. House conservatives, backed by the leadership, squared off against the Appropriations "Cardinals" who direct the content of the 13 bills which allocate the vast Federal budget. The House conservatives surprisingly won several showdowns against the normally unassailable committee chairmen when backed by the rediscovery of fiscal restraint as a tenet of conservatism shared by many GOP voters. A raid by the Justice Department on the Congressional office of Representative William Jefferson (D-LA) forced usual foes Speaker Dennis Hastert (R-IL) and Minority Leader Nancy Pelosi (D-CA, San Francisco) to unite in decrying the first direct raid on an office of the Legislative branch by the Executive in 219 years. The leaders' obtuse claims of Constitutional prerogatives seemed to play poorly in an atmosphere of expanding corruption probes against various legislators of both parties.

All wagers, including those ones placed early, will pay or lose in November, still an eternity away as measured in political time, when today's triumphs can become tomorrow's blunders. Polling continues to auger trouble for incumbents of both parties as public disapproval over war, energy, and immigration fuel dissatisfaction, with a fortune to be spent framing issues, attacking positions, and assessing blame.

## **Issues and Events**

### **Exec Comp Bill Gets Surprise Hearing**

CalPERS Senior Investment Officer for Global Public Equity Christy Wood told the House Committee on Financial Services in her testimony May 25 that executive compensation policies should be more transparent to those paying the bills, as required by H.R. 4291 by Congressman Barney Frank (D-MA).

Frank arranged the executive compensation hearing through a crafty procedural maneuver last month and relationships with the majority, including Chairman Michael Oxley (R-OH), were sufficiently healthy for the hearing to go forward without hard feelings or significant opposition; rather than ignore the event, Committee Republicans arrived ready to argue in earnest for a hearing that ran over three hours. Republican questioners appeared to use the hearing as a forum on the relative merits of capitalism versus socialism, comparing CEO compensation with, for example, the payments received by trial attorneys. The opening statements of various Members reflects the general outlook of the parties on this issue, with Republicans reluctant to interfere with corporate America and Committee Democrats generally supportive of the need for, and means of, reforming executive compensation.

Wood told the Committee that, "In a perfect world, we wouldn't need government to call companies to account for how they pay their executives. Since this isn't a perfect world, we are seeking the rule of law not to set salaries, but to require companies to show us the money; to show those who own the companies what they are paying their executives -- and why." The testimony of the Business Roundtable (BRT) argued instead that the current system functioned well, when viewed through accurate numbers, and that independent boards and shareholders have the tools they need to deal with "extreme cases" of over-the-top executive compensation. The BRT said that the approach of HR 4291 was "a slippery slope that should be avoided -- if this model were applied to CEOs, then, by extension, the public would determine salaries for news anchors, movie stars, athletes, and elected officials."

### **Prospects Dim for Public Pension Tax Provisions**

The GOP majority secured a victory on tax legislation when the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) became Public Law PL 109-222 on May 17. The law extends tax preferences for capital gains and dividends through 2010. With many items on the tax "wish list" undone, members are preparing a second measure known as the "trailer" bill. This legislation will feature popular tax breaks for education and research expenses and leaders have reportedly agreed to attach the provisions of the long-stalled pension conference to this vehicle.

The trailer bill faces a more difficult time under Senate budget rules. Although TIPRA enjoyed protection against the 60 vote point-of-order hurdle so long as it cost \$70 billion or less, the trailer has no procedural shield if it has *any* net cost. This position provokes two contrary yet oddly complementary dynamics for those crafting the legislation. On one hand, the bill will almost certainly need 60 votes in support, which argues for inclusion of popular items to draw votes; on the other, big ticket items will draw the opposition of deficit hawks who have generally recommitted themselves to budget discipline in matters which do not involve war or tax cuts.

With these constraints in mind, the EGTRRA provisions favored by public plans and included in the House version of pension reform face a grim future. Overall, private plans on the razor's edge of termination provided the political steam driving pension reform, with the EGTRRA measures added to time-sensitive legislation on the same topic. But the EGTRRA permanency provisions found in the House bill are very expensive, at nearly \$28 billion, and their cost weighs against them in a way that preemptive extension of the capital gains tax break does not. All items are now scrutinized through the lens of the coming elections, and Congressional GOP leaders may not feel it is worth angering budget-cutters in order to boost employee retirement options. Unless EGTRRA inclusion can bring in significant Democratic votes, the political math may not add up for the GOP majority. As a result, public plan leaders should brace themselves for disappointment in the development of Congressional priorities under the current leadership.

### **Health IT Chances Advance Through Choppy Political Waters**

The House Ways and Means Subcommittee on Health considered and approved H.R. 4157, legislation by its Chairwoman, Nancy Johnson (R-CT) to facilitate health information technology (IT) and grant legislative sanction to the National Coordinator for Health Information Technology within the Department of Health and Human Services (HHS). The current office exists by virtue of an executive order from the President.

Johnson's bill advanced with a few changes carried by the chairman's amendment on a party line vote of 8-5 as the majority once again shut down Democratic amendments to make the legislation tougher on the Administration. Amendments from the minority sought more explicit privacy standards and a firm deadline for Medicare providers to use the system by 2015 or lose their reimbursements. GOP members said that including a nine year deadline would likely actually postpone adoption of the system by providing that much time for the disparate elements of the health system to lollygag rather than bite the bullet (and swallow the costs) needed to integrate themselves into the network. This House Health IT bill also does not provide funding authorization to further its goals.

In his opening statement, Pete Stark (D-CA, Fremont), Johnson's Democratic counterpart on the Health Subcommittee, expressed disappointment. It says in part: "Although we (Democrats) have offered suggestions, annotated language and compromises, you have consistently rejected the opportunity to work together on this issue....This is unfortunate, because health information technology should be a no-brainer for bipartisanship.... the bill you have crafted does not bring us closer to a nationwide interoperable health system...(but) it also includes provisions that actually make things worse."

Stark criticized the lack of authority for the new national office and the Secretary of HHS to craft standards, the easing of anti-kickback and self-referral provisions, and potential compromises to privacy and confidentiality. Instead, Stark said the House should put forward a plan with deadlines, funding for compliance, and a requirement to use the new system. These issues reflect the fundamental debate over the details of health IT, which have held up legislative action on the topic for years.

Although many health pros see the Johnson legislation as somewhat half-hearted and overly tentative, movement of the bill is nonetheless a positive development. The real show, however, may be at the Energy and Commerce Committee, which held a hearing on health IT issues in March of this year. Energy and Commerce will likely craft its own bill to report to the floor, which most observers think will be within a month. That Committee's product is more likely to resemble the Senate's S.1418, passed last November with overwhelming bipartisan support.

The House plans to showcase its commitment to health policy sometime in June with a presentation of its major policy recommendations such as malpractice reform and expanded Health Savings Accounts (HSA), all of which were defeated in the Senate and thus cannot be enacted into law since they lack Senate-approved companion measures. As reported here last week, Health IT also has a fair shot at House approval, and that such legislation could be conferenced with S.1418 to at last produce new law. Should that scenario occur, health IT would be one of the few actual healthcare achievements to be sent from the Congress to the President before the November elections.

Policy experts from all points of the political spectrum and virtually all participants in the sprawling health care system support most basic points of the legislation seeking to boost the use of technology in health administration. HHS estimates suggest that broad use of interoperable electronic health records could save as much as \$140 billion annually in health care costs.

## **California Congressional Delegation**

### **Thompson Tries to Show Us The Money on Health IT**

During consideration of the Health Information Technology (IT) bill mentioned earlier, Democratic Congressman Mike Thompson (Eureka) offered an amendment to provide authorization for funding the measure. His initiative was defeated by voice vote, joining the pile of Democratic amendments to splinter against the closed ranks of Committee Republicans. In the Federal system, allowing money to be spent, budgeting money to be spent, and allocating money to be spent are all separate operations. Thompson proposed providing the first condition for use of resources by placing a marker in statute that indicates Congress approves of spending up to a given amount on developing the interoperable system.

## **Calvert Wants Faster FDA Approval of Generic Drugs**

In a meeting with governmental health plan representatives, staff to Republican Congressman Ken Calvert (Riverside and Orange counties) stressed his interest as Co-Chairman of the Generic Drug Equity Caucus in working for faster approval of generics by the Food and Drug Administration (FDA). The Caucus is a bipartisan organization dedicated to consumer access to generic drugs, competition between brand-name and generic drug companies, and use of generics to control health care costs. The Public Sector Healthcare Roundtable, chaired by Jarvio Grevious, Deputy Executive Officer, CalPERS' met with Calvert's staff in May to discuss common interest in broader use of generic drugs to ease prices pressure on benefit plans and their members.

## **Waxman Opposes Drug Deals...**

... Especially among drug companies. Democratic Congressman Henry Waxman (Los Angeles) joined Senator Charles Schumer in writing to the heads of two large trade associations involved in the "resurgence in patent agreements in which a brand name pharmaceutical company pays a generic firm to keep its drug off the market." Congressman Henry Waxman (D-CA) and Senator Charles Schumer (D-NY) urged the Pharmaceutical Research and Manufacturers of America (PhRMA) and Generic Pharmaceutical Association (GPA) to strongly and publicly oppose the practice.

The letters trace the evolution of the practice from a way to end or prevent costly litigation to what some see as a broad-based anti-competitive practice. A pair of 2005 appellate court decisions overturning the Federal Trade Commission's (FTC) disapproval of these deals triggered a new round of agreements among competitors to essentially not compete.

The lawmakers call upon the drug groups to stick up for the consumer and "immediately express your strong opposition to these settlement agreements that serve only to benefit the drug companies involved while depriving consumers of the great cost-savings of generic drugs." The FTC is pressing its position in the Federal courts, with a hearing before the U.S. Supreme Court expected.

The U.S. Solicitor General – the Administration's advocate and nexus to the Supreme Court – filed an amicus brief arguing against the Supreme Court hearing the case. The brief claimed that the pending case (*Schering-Plough v. FTC*, 402 F 3d. 1056 [11<sup>th</sup> Cir. 2005]) does not present a good set of facts for resolving the underlying policy issues and that the absence of disagreement among the Federal circuit courts makes this case an inappropriate one for Supreme Court review.

## **Related National and Industry News**

### **Congressmen File SOX 404 Cutback Bill**

On May 17<sup>th</sup>, the SEC announced a further "brief postponement of the Section 404 requirements for the smallest company filers, although ultimately all public companies will be required to comply with the internal control reporting requirements of Section 404." The release lays out the next steps in the Commission's rulemaking process and makes official the SEC's position that no exemption will be forthcoming from the regulatory side of the equation – at least for the time being.

It was likely not coincidence that later during the day Congressman Tom Feeny (R-FL) introduced H.R. 5405 to "reduce the burdens of the implementation of section 404 of the Sarbanes-Oxley Act of 2002." Senator Jim DeMint (R-SC) introduced the companion Senate measure, S. 2824. The bills, entitled the "COMPETE Act," would exempt companies with less than \$700 million in market value from the Section 404 provisions, the heart of Sarbanes-Oxley which requires proof of independent auditors and strong internal controls against fraud. The bills also seek to promote clarity in what constitutes "material weakness" in internal controls, set a standard for negative audits at a mistake greater than 5% of the firm's net profits, and make other changes to ease the audit requirement on companies not exempted entirely.

In general, large companies have asked for open, general rules which will allow them to take their own paths to SOX compliance, while smaller ones have requested a strict list of needed procedures so that they will not waste time or resources trying to comply. The SEC continues to seek balance between these requests as it develops regulations for the complex law.

Supporters of the SOX 404 rollback bill include several Members serving on the committees of jurisdiction, Banking in the Senate and Financial Services in the House. Congressman Feeny used the Memorial Day recess to issue an editorial saying that Section 404 simply imposes more costs than it is worth. Since enactment of Sarbanes-Oxley, foreign capital has flocked to non-American exchanges, with the London Stock Exchange billing itself as a "SOX Free Zone," according to Feeny. He asserts that the COMPETE Act aims to "advance the reasonable application of Sarbanes-Oxley" and to "keep that which is a net advantage to investors" while "eliminat(ing) those provisions which are a net disadvantage."

However, the Chairman of the House Committee, Michael Oxley (R-OH), who co-wrote the law in question, has said that he has no plans to move on SOX-related legislation this year.